IMF cuts growth forecast in the wake of Brexit

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The International Monetary Fund has revised down its forecast for global growth in 2016 as a direct result of the British referendum decision to quit the European Union. IMF chief economist Maurice Obstfeld said the fund had been prepared to deliver an upgrade on its world growth projection but the Brexit vote had "thrown a spanner in the works."

Overall the IMF cut its global growth forecast for 2017 by 0.1 percentage points. But the downgrades for the United Kingdom (UK) were much more significant. After cutting its UK forecast by 0.2 percentage points from its April forecast for this year, it reduced the growth prediction for 2017 from 2.2 to just 1.3 percent, the largest decline for any advanced economy.

The impact on the UK may be even more significant than forecast by the IMF. Private economic forecasters have warned its economy will stagnate next year, in contrast to the IMF estimate of 1.3 percent growth for 2017.

The European Commission has forecast that UK growth could fall by as much as 2.6 percentage points, with the economy contracting by 0.3 percent next year.

The IMF update warned that the Brexit vote "implies a substantial increase in economic, political and institutional uncertainty, which is projected to have negative macroeconomic consequences, especially in advanced European economies."

The IMF acknowledged the outcome could be worse than the present downgraded forecasts. These were based on "benign" assumptions that uncertainty after the Brexit vote would gradually wane. However, it warned that "more negative consequences are a distinct possibility."

Such "downside risks" include the possibility of tighter financial conditions and weaker consumer confidence than presently anticipated. It set out a "severe scenario" in which there was increased financial stress due to trade relations between the UK and the EU reverting to World Trade Organisation norms, rather than any special relationship. Under such conditions, "the global economy would experience a more significant slowdown" that would be more pronounced in the advanced economies.

The impact of the Brexit vote extends beyond Europe. The IMF said the uncertainty it has generated would impact on Japan, pushing up the value of the yen, which hits Japanese exports, reducing growth by 0.2 percentage points this year to just 0.3 percent.

The IMF did not anticipate Brexit would have a significant impact on China because of its limited trade links with Britain but warned that if growth in the EU were "affected significantly, the adverse effect on China could be material."

This is because the EU is China's largest export market.

The IMF pointed to financial instability which could be increased by Brexit, noting what it called "unresolved legacy issues in the European banking system, in particular in Italian and Portuguese banks."

Italian banks alone have some €360 billion in non-performing loans on their books and the Italian government of Prime Minister Matteo Renzi is seeking to organise a bailout. Such a move could bring his government into conflict with the rest of the EU, above all Germany, because EU regulations prohibit direct bailouts by national governments.

The financial instability is not confined to Italy and Portugal but extends throughout the euro zone, including Germany, because of the failure of European banks to recapitalise sufficiently after taking a hit as a result of the 2008 financial crisis. They had hoped that economic growth would create the conditions where

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problems could be overcome. The failure of that growth to eventuate has resulted in their further weakening.

Besides the immediate financial and trade impacts, the IMF pointed to the political consequences of the Brexit decision, which expressed the deep-seated hostility of broad masses of the population to the political, business and financial elites—a hostility that is universal in all major economies.

It said "political divisions" within advanced economies "may hamper efforts" to implement "long-standing structural challenges" and that "a shift towards protectionist policies is a distinct threat."

The continued fall in growth for the advanced economies—they are expected to expand by only 1.8 percent this year compared to the forecast of 2.4 percent last year—coupled with mounting hostility towards the entire political and economic establishment is fueling concerns among economic and financial pundits over the stability of the present order.

Financial Times economics commentator, Martin Wolf, added his voice to these warnings in a column published on Wednesday. He denounced the solutions offered by such aspirants to power as Donald Trump in the US and Marine Le Pen in France, based on "nationalism, nativism and protectionism," as bogus.

"But the illnesses are real," he continued. "If the governing elites continue to fail to offer convincing cures, they might soon be swept away and, with them, the effort to marry democratic self-government with an open and co-operative world order."

But the solutions offered by Wolf were far from convincing. Among other things, he called for a "reform" of capitalism, curbing the "excessive" role of finance, greater international co-operation, greater support for aggregate demand, especially in the euro zone, and a fight against economic quacks.

He concluded with a passage which is a measure of the growing fear of what the deepening economic malaise signifies. The biggest single issue, he wrote, was to "recognise the challenge" because "our civilisation itself is at stake."

But like all would-be-reformers of the capitalist system, Wolf has continually failed to explain why all the measures he advances to ensure its stability have been continually rejected at the highest levels of the political and financial establishment and the flow of economic events continues in the opposite direction.

The reason lies in the fact that the present course is not rooted in an incorrect mindset of the political and financial elites, and therefore subject to correction by the "sweet reason" offered by Wolf and other like-minded commentators, but arises from the irresolvable contradictions of the profit system itself.

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